FILED
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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1976

No. 75-1460

IN THE MATTER OF:
PENN CENTRAL TRANSPORTATION COMPANY, *Debtor*
PEORIA AND EASTERN RAILWAY COMPANY, *Petitioner*
PENN CENTRAL TRANSPORTATION COMPANY
TRUSTEES IN BANKRUPTCY, *Respondents*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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BLEED THROUGH

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1976

No.

IN THE MATTER OF:

PENN CENTRAL TRANSPORTATION COMPANY,
Debtor

PEORIA AND EASTERN RAILWAY COMPANY,
Petitioner

PENN CENTRAL TRANSPORTATION COMPANY,
TRUSTEES IN BANKRUPTCY, *Respondents*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Petitioner, the PEORIA AND EASTERN RAILWAY COMPANY, prays that a Writ of Certiorari issue to the United States Court of Appeals for the Third Circuit to review the judgment order dated January 12, 1976, of that Court, affirming the order of the United States District Court for the Eastern District of Pennsylvania, No. 70-347, sitting in bankruptcy.

OPINIONS BELOW

The opinion and order of the United States District Court for the Eastern District of Pennsylvania, sitting in bankruptcy, entered on April 23, 1975, is reported at 392

F. Supp. 960 (1975). A copy of this opinion is appended hereto at p. A1. The judgment order of the United States Court of Appeals for the Third Circuit affirming the order of the District Court has not yet been reported. A true and correct copy of the said judgment order is however appended hereto at p. A8.

JURISDICTIONAL STATEMENT

The judgment order of the United States Court of Appeals for the Third Circuit, affirming the decision of the District Court, was entered on January 12, 1976. The petition of the Peoria and Eastern Railway Company for a rehearing in banc was denied on February 10, 1976, and no order has been entered granting any extension of time in which to file a Petition for Certiorari. The jurisdiction of this Honorable Court is invoked pursuant to 28 U.S.C. §1254(1).

STATEMENT OF THE ISSUES

1. Whether the United States Supreme Court should resolve the issue of federal law which arose when the Third Circuit Court of Appeals ruled that a non-operating railroad's share of the proceeds in a "division of earnings" situation was not subject to the imposition of a trust in favor of the non-operating line in railroad reorganization proceedings, despite a holding by the Seventh Circuit Court of Appeals that the non-operating line's share of the proceeds was subject to the imposition of such a trust.

2. Whether the Third Circuit Court of Appeals should be allowed to permit the Penn Central Trustees, in bankruptcy, to ignore Petitioner's status as a *de facto* interline carrier, which status was imposed upon the Petitioner, a non-operating railroad, by the ICC, when the action of the court of appeals threatens the Petitioner's solvency during the Penn Central railroad reorganization proceedings.

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CONSTITUTIONAL AND STATUTORY PROVISIONS

[None Cited]

STATEMENT OF THE CASE

The instant case is a proceeding to impress a trust upon funds held by a bankrupt railroad corporation, the Penn Central Transportation Company (hereafter "Penn Central"), which funds were collected by the Penn Central for and on behalf of the Peoria and Eastern Railway Company (hereafter "P & E"), the Petitioner herein. The Penn Central Trustees are the Respondents in this controversy, which arises out of the bankruptcy and reorganization proceedings of the Penn Central. On May 10, 1974, the P & E filed a Petition to Impress a Trust on funds held by the Penn Central, and the Penn Central Trustees filed their answer in opposition. After hearing oral argument, the District Court on April 23, 1975, denied the P & E's petition, following which the P & E filed an appeal with the United States Court of Appeals for the Third Circuit.

On January 5, 1976, the Court of Appeals for the Third Circuit heard oral argument, and thereafter, on January 12, 1976, the Court of Appeals entered a judgment order affirming, without opinion, the decision of the District Court. On February 10, 1976, the Court of Appeals denied the P & E's Petition for Rehearing in banc. Thereafter, the P & E filed the instant Petition for Certiorari with the Supreme Court of the United States.

The P & E, an Illinois corporation, is a non-operating railroad owning a single line in Indiana and Illinois with a length approximating two hundred (200) miles. Since the formation of the company in 1890, its railroad has been operated by the Cleveland, Cincinnati, Chicago and Saint Louis Railway Company (hereinafter referred to as the "Big Four") or its successors or assigns under an operating agreement dated February 22, 1890, as renewed and amended.[1]

1. The original 50-year agreement was renewed as of April 1, 1940, for 20 years, again as of April 1, 1960, for 10 years, and also as of April 1, 1970, for 5 years. Interstate Commerce Commission (hereafter "ICC") approval of that renewal was

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Under the Operating Agreement, the P & E granted to the Big Four, its successors and assigns, subject to mortgage rights, the right to use and operate its line, rolling stock and equipment. The Big Four has not, itself, operated the P & E property since February 1, 1930. On that date, operation of the P & E's property was undertaken by the New York Central, under a ninety-nine (99) year lease dated January 2, 1930, wherein the Big Four leased, transferred and assigned to the New York Central all of its property, including its rights under the Operating Agreement. This lease was recognized and approved by the P & E in its 1940 renewal agreement with the Big Four. Since February 1, 1968, the P & E's properties have been operated by the Penn Central Transportation Company as corporate successor to the New York Central.

Under the Operating Agreement, the Penn Central operates and maintains the property of the P & E for the account of the P & E. Penn Central collects the revenues derived from the P & E's operation, and, from the funds collected, pays the expenses of operation and maintenance. *The Penn Central pays the P & E no "rent", since clearly the relationship is one created and controlled by an Operating Agreement, not a lease;* rather, within sixty (60) days after the close of the calendar year, the Penn Central must divide the earnings, account to the P & E and pay to it all remaining "net income" from the year's operations.[2]

Thus, it is clear that interest accrues only if there has been no accounting within 60 days following the end

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received. Within the past year, the Trustees of the Big Four and the Trustees of the Penn Central filed a petition with the District Court sitting in bankruptcy to extend the Operating Agreement for a 2-year period. That petition has been approved.

2. The original Operating Agreement required "the balance of . . . net earnings and income" to be paid to the P & E. ICC approval of the 1960 renewal agreement was conditioned *inter alia* on the requirement that the P & E be paid any unexpended balance in the P & E depreciation accounts, plus interest. In accordance

of the calendar year. Under the "division of earnings", the Penn Central paid the P & E $326,024.00 for the calendar year 1968 and $581,362.00 for the calendar year 1969. As calculated by the office of the Penn Central's Manager of Corporate Accounting, the amount due the P & E under the Operating Agreement for the year 1970 is $797,213.00. Similar calculations prepared in the office of the Manager of the Corporate Accounting Department of the Penn Central indicate that the following amounts are due the P & E: $1,241,771.00 for the year ending December 31, 1971; $942,919.00 for the year ending December 31, 1972; and $937,265.00 for the year ending December 31, 1973. Demand for payment of these amounts (which were derived from the operations on the P & E's line, and which are collected by the Penn Central for the account of the P & E) has been made on behalf of the P & E to the Penn Central Trustees but no portion of these amounts has yet been paid.

The arrangement under the Operating Agreement is regarded by the P & E not as a lease, but rather as a unique fiduciary arrangement in which the Penn Central acts as Trustee and agent for the P & E in administering the division of earnings. This arrangement is asserted by the Trustees of the Penn Central to be a mere debtor-creditor relationship. Respondents in their Answer to the Petition to Impress a Trust admit that a lease is not involved in the instant case and it is clear that no other such Operating Agreement relationship exists involving the Penn Central, since it entered into leases in every

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Footnote 2 continued

with the ICC requirement, the Operating Agreement was amended in 1964 to require that P & E be paid "the amount determined by the balance in inter-company accounts with the [P & E] including the amounts in the accounts regarding depreciation . . . with interest at the rate of 6% per annum on the amount so required to be paid from the date such amount becomes certain until paid." *Thus, no interest is accrued unless payment is delayed more than 60 days after the amount becomes certain.*

other instance in which it operates another line. Under this arrangement, the Penn Central maintains special bookkeeping accounts for all the P & E operations so that all expenses and income are properly debited and credited to the operations of the P & E and a detailed accounting can be made available.

The Penn Central has a controlling interest in the P & E since it owns 30% of the P & E's outstanding stock, and owns approximately 97% of the stock of the Big Four, which, in turn, owns approximately 50% of the stock of the P & E. However, the remaining 20% of the P & E stock is neither owned nor controlled (either directly or indirectly) by the Penn Central and is in fact publicly held and traded. Through this stock ownership, the Penn Central has insured that four of the five directors of the P & E are Penn Central employees.

Throughout these proceedings, the questions presented appear to be ones of law rather than fact, since the facts have not really been disputed by the parties hereto.

REASONS FOR GRANTING THE WRIT

A. An Issue Is Presented for Decision by the United States Supreme Court Resulting From a Conflict Between Circuits Where the Seventh Circuit Recognizes a Trust in Circumstances Such as Those Existing in the Instant Case, But Where the Third Circuit Has Refused to Do So.

Based upon the undisputed facts which were initially presented to the District Court, sitting in bankruptcy, in the instant case, it is clear that what the P & E seeks is its annual share of the "net proceeds" or "earnings" resulting from the operation of its line. The P & E requested the Court to recognize a resulting trust over the funds which were collected by the Penn Central on its behalf, based upon the legal doctrine which states that where an agent collects funds on behalf of his principal, he holds those funds in trust for the principal and must account for and turn them over upon demand to his principal. This doctrine was firmly established and recognized by the Third Circuit Court of Appeals in *In Re Penn Central Transportation Company, Appeal of Indiana Harbor Belt Railroad Company, et al.* and elsewhere:

> "The AAR interline accounting system is in essence, therefore, a system by which one railroad collects monies owed by shippers to both itself and other railroads. The monies collected belong only in part to the collecting railroad; as to monies owed other railroads, the collection agent serves merely as a receiving and transmitting agent. *A common sense interpretation of this system would indicate that funds collected by one railroad for and in behalf of another railroad are held in trust by the collecting railroad until the monies are transmitted.* Whether the money is held in trust must be determined, how-

> ever, not merely by reliance on common sense, but also by application of traditional legal doctrine. . . . Accommodating and applying the traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads, we have concluded the transportation and freight charges, *when collected*, are held in trust for the Interline. They are, therefore, entitled to have their monies." *In Re Penn Central Transportation Company, Appeal of Indiana Harbor Belt Railroad Company, et al.*, 486 F.2d at 523-524 (3 Cir. 1973). See also, *e.g. Terre Haute and I.R. Co., et al. v. Cox*, 102 F. 825 (7 Cir. 1900). (Emphasis Added.)

The issue before this Court, in the present matter, is whether or not this principle applies in a "division of earnings" situation, such as that which exists in the instant case. The Circuit Court of Appeals for the Seventh Circuit has established that the doctrine of resulting trust is properly applied to analyze and resolve such situations. *In Terre Haute & I. R. Co., et al. v. Cox, supra.*, the Court analyzed a division of earnings situation such as that in the instant case. There, the railroad operating the Peoria line (which was the then insolvent Indianapolis Railroad) was required to pay 30% of gross earnings to the Peoria Line, and it failed to do so because it was insolvent. (In the instant case, the Penn Central is required to turn over the P & E's "net earnings", and it has not done so, contrary to the terms of the Operating Agreement, apparently due to a lack of cash during the bankruptcy and reorganization proceedings.) In *Terre Haute, supra.*, the Court ordered the Receiver of the insolvent Indianapolis Railroad to turn over the funds in question to the Peoria Line, stating:

> "The money constituting the thirty per centum . . . is, it is true, physically in the possession of the Indianapolis Company, but *equitably and beneficially*

becomes, the moment it is earned, the property of the Peoria Company. . . ." 102 F. at 833. (Emphasis Added.)

Since both the *Terre Haute* case and the instant case involve a "division of earnings" in which one railroad company collects revenues for and on behalf of another railroad, it would appear that the Court of Appeals for the Third Circuit was bound to recognize a resulting trust in favor of the P & E and order the Penn Central Trustees to turn over the funds in question. The fact is, of course, that this issue, although analyzed in terms of a resulting trust and depending upon citations to earlier cases, is nevertheless an issue of current interest, since such an analysis formed part of the basis for the 1973 decision of the Third Circuit Court of Appeals in the case of *Indiana Harbor Belt Railroad Company, supra.* That decision as well would appear to compel and require the turnover of the funds held by the trustees to the P & E.

Nevertheless, despite authority relied upon in the 1973 decision, the Court of Appeals for the Third Circuit, in the instant case, refused to recognize a resulting trust in circumstances which, as indicated, appear virtually identical to those in which the Seventh Circuit Court of Appeals previously found a resulting trust. In view of the current importance of the Penn Central Railroad reorganization proceedings, and of the confusion engendered by the conflict among the circuits (and, as noted below, within the Third Circuit itself), the intervention of the Supreme Court is required because it alone can resolve with clarity and finality these compelling issues.

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B. In Addition to the Conflict Noted Above, the Conflict Between the Decision of the ICC, Recognizing the De Facto Interline Carrier Status of the P & E, and That of the Third Circuit Court of Appeals Denying Recovery on the Ground That the P & E Was Not a De Facto Interline Carrier (as Well as the Conflict Within the Third Circuit) Presents an Important Question of Federal Law Which Can Only Be Resolved by Decision of the Supreme Court.

The decision of the Third Circuit Court of Appeals, conflicts not only with the decision of the Seventh Circuit Court of Appeals in *Terre Haute, supra,* but also with the decision of the Interstate Commerce Commission in *Wood v. New York Central Railroad Company, et al.*, 286 ICC 373. The decisions of the lower courts appear to have overlooked the import of the fact that the P & E was a *de facto* interline carrier, and so designated by the ICC because a recognition of that status as an interline carrier is, under the *Indiana Harbor Belt* doctrine, the fact which triggers the finding of a resulting or constructive trust:

> "Accommodating and applying traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads, we have concluded the transportation and freight charges, *when collected,* are held in trust for the Interlines. They are therefore entitled to have their monies." 486 F.2d at 524.

The Court of Appeals' holding, in the instant case, thus stands in obvious conflict not only with the ICC's Decision in *Wood* and the Seventh Circuit's Decision in *Terre Haute* (as noted above), but also with Judge Rosenn's decision in *Indiana Harbor Belt, supra.*

The problem presented by the conflicting principles enunciated in these contradictory decisions is that a railroad, such as the P & E, found by the ICC to retain enough of the characteristics of an interline carrier, cannot gain sufficient predictability and consistency in the law, as it now stands, to determine what steps it must take to protect its legitimate interests. Only a decision by the Supreme Court can resolve these conflicting issues and clarify the legal standards, on these issues, under which rail reorganizations are to proceed. Due to the public importance of this issue, both in the Penn Central reorganization and in other railroad reorganization proceedings the P & E prays the Supreme Court to grant its Petition.

CONCLUSION

Non-operating rail lines, such as itself, which are participating in the reorganization proceedings of the Penn Central, are subjected to a contradictory set of legal principles caused by the conflicting decisions of the Third and Seventh Circuits, the conflict in decisions within the Third Circuit itself and the conflict between the decisions of the Third Circuit and the ICC. The effect of these contradictory and conflicting decisions has complicated and retarded the Penn Central reorganization proceedings and has subjected rail lines, such as the P & E, to a high degree of uncertainty, thereby leaving them defenseless in their desire to protect their legitimate interests. In order to alleviate this critical situation and to resolve those important issues of federal law which are presently obstructing rail reorganization proceedings, not only in the instant case but also in other such reorganization pro-

ceedings, the P & E prays that this Honorable Court grant its petition and decide the issues raised herein.

Respectfully submitted,

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APPENDIX

BLEED THROUGH

In the Matter of
PENN CENTRAL TRANSPORTATION CO.,
Debtor

No. 70-347

United States District Court
E. D. Pennsylvania

April 23, 1975

* * * *

Memorandum and Order No. 1855

FULLAM, J. April , 1975

The Peoria & Eastern Railway Company (hereinafter referred to as the "Peoria") has petitioned to impress a trust upon the assets of the Debtor. The Peoria is a non-operating railroad owning a single line in Indiana and Illinois. The Peoria's properties have been operated by the Debtor since February 1, 1968, pursuant to an operating agreement under which the Debtor pays the expenses of operation and maintenance, and collects the revenues derived from the operation of the railway.

The operating agreement provides that the Debtor must account to the Peoria within 60 days after the end of each calendar year and must pay the Peoria all the remaining "net income" from the year's operation. Generally, this would require the Debtor to pay the balance in the inter-company account, including any balance in the depreciation account, together with interest at the rate of 6% yearly from the date the amount becomes certain, until it is paid.

During reorganization, the Trustees of the Debtor have not made any payments to Peoria under the agreement. The calculations prepared by the Trustees, and

apparently approved by the Peoria, show that the Peoria is owed $3,919,168 under the operating agreement for the years 1970 through 1973. The Trustees have refused to pay this balance on the theory that the Peoria is merely a leased line. The Trustees argue that where, as here, the Trustees have not taken definitive action to either affirm or reject the agreement, the Debtor may withhold the payment of the rental due until this determination is made. Section 77 of the Bankruptcy Act, 11 U.S.C. §205. The petitioners have not challenged this general proposition, but rather argue that:

> "The Arrangement under the operating agreement is not a lease, but rather a unique fiduciary arrangement in which the Penn Central acts as a trustee for the Peoria."

If the $3,919,168 was held in trust, as argued by petitioner, then the Peoria would have a right to receive these funds notwithstanding the Debtor's reorganization. But if the Peoria is actually a leased line, as argued by the Trustees, a debtor-creditor relationship would arise.

Obviously, the pivotal issue raised by the present petition is the question of whether the operating agreement between the Debtor and the Peoria resulted in the creation of a "trust" relationship between the railroads, or a debtor-creditor relationship. Nowhere in the terms of the operating agreements is the relationship between these railroads described as either a "trust" or a "lease" arrangement. Although there is clearly no express trust created by the operating agreement, petitioner argues that the Court should find an implied trust or impress a constructive trust on Debtor's assets. As was stated by the Third Circuit Court of Appeals in *In the Matter of Penn Central Trans. Co., Appeal of Indiana Harbor Belt R.R. Co., et al.*, 486 F.2d 519, 524 (3d Cir. 1973):

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> "When the language of the parties fails to clearly indicate their intention, [the trust] may be ascertained by other objective manifestations of intent, such as the facts and circumstances surrounding the transaction and the relationship of the parties."

Although not conclusive, one factor in distinguishing between a trust relationship and an ordinary debt is whether or not the recipient of the funds was entitled to use the funds as his own, and commingle the funds with his own. *See Scott on Trusts*, 3d ed. §12.2. The parties in this action agree that all monies derived from the operation of the Peoria were placed in the general funds of Penn Central. No segregated fund for the account of the Peoria was maintained by Penn Central, nor is there any suggestion in the record that Peoria requested that "its" funds not be commingled with the Debtor's general funds. Generally, "commingling indicates a creditor-debtor relationship and not a trust." *Appeal of Indiana Harbor Belt R.R. Co., supra*, at 524.

A second factor to consider is the presence in this operating agreement of a provision for the payment of interest by the collecting carrier. As was mentioned above, the agreement provides for the payment of 6% annual interest on all "net income" due the Peoria which is not paid within 60 days of the close of the calendar year. Although not conclusive, the presence of a provision for the payment of interest indicates the presence of a debtor-creditor relationship. As was stated by the Third Circuit Court of Appeals, "the debtor-creditor relationship entails the right to use another's money, the usual *quid pro quo* for which is the obligation to pay interest." *Appeal of Indiana Harbor Belt R.R. Co., supra*, at 524. See 1A Scott, *Law of Trusts*, §12.2, at 108.[1]

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1. The Peoria advances the theory that this 6% interest charge is not really interest at all, but rather is in "the nature

The evidence of commingling of funds, as well as the presence of the interest provision in the operating agreement, supports the Trustees' position. The Trustees' position is further supported by the "facts surrounding the transaction and relationship of the parties." *Appeal of Indiana Harbor Belt R.R. Co., supra,* at 524. The burden is on the petitioner to prove the existence of a trust relationship, and this burden has not been met.

The most significant argument raised by petitioner is that this case is controlled by the Third Circuit Court of Appeals' holding in the Appeal of *Indiana Harbor Belt R.R. Co.* case.[2] In that case, the Court of Appeals held where

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of damages or a penalty for breach of the relationship between the parties." In support of this position, Peoria points out that interest is not due on this account until 60 days after the close of the calendar year, thus suggesting that the interest charge is really a liquidated damage provision against the "trustee" for breach of the trust instrument. However, there is an alternative, and equally plausible explanation for the 60-day delay in charging Penn Central interest on the Peoria account. Penn Central's collection of the revenue attributable to the operation of the Peoria Railway in any given year could extend well into the following calendar year. Obviously, the Debtor would not pay interest on Peoria's revenue unless the Debtor had the money in hand. The 60-day lag period provides the Debtor with an opportunity to collect the accounts receivable from the previous year and to determine the amount of Peoria's monies it intends to use for its own benefit. This lag period offsets the Debtor's right to use Peoria's monies received during the first 60 days of each calendar year against revenues which are merely accounts receivable to the Debtor which cannot be collected until some time after the expiration of the 60-day period.

2. Petitioner cites *Ewen v. Peoria & Eastern Ry Co.*, 78 F. Supp. 312, 315-17 (S.D.N.Y. 1948) for the proposition that this operating agreement has been interpreted as establishing a trust arrangement. This interpretation of the *Ewen* case is overly generous. In *Ewen*, the Peoria alleged that the New York Central Railroad (one of the predecessors of Penn Central) had improperly accounted for funds due the Peoria. Because the New York

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there is interline movement of passenger and freight traffic, and the Debtor acts as a collecting agency for all of the railway lines involved in performing services for the joint transportation venture, the Debtor holds the funds collected as trustee for the other railroads. The critical factor in determining the existence of a trust arrangement in that case was the Court of Appeals' conclusion that the Debtor was collecting money for services performed by other carriers.[3]

Unlike the interline situation, the Debtor does not collect money for the Peoria account for services performed by the Peoria. Under the operating agreement, the Debtor operates and maintains the property of the Peoria. The Peoria performs no services similar to those provided by railroads participating in interline movements. Although there are approximately 160 people who are employed to work on the Peoria's properties, they are regarded and treated as Penn Central employees. All of these employees are included on the Debtor's payrolls, paid with the Debtor's checks, and are covered by the basic labor agreement that applies throughout the Debtor's system. These employees operate the locomotives and the handling of the switching,

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Central was the Peroria's majority stockholder, the court held that the New York Central had a fiduciary duty not to "use its power to prejudice" the rights of the minority shareholders. The court's discussion of the New York Central's fiduciary duties arose in the context of these allegations of improper accounting, and there is no suggestion in the *Ewen* opinion that a trust relationship between the railroads arose *per se* from the operating agreement. Since there is no allegation of improper accounting by the Debtor in the present matter, the *Ewen* case is inapplicable in the context of this case.

3. *In re Penn Central Trans. Co., supra,* at 528. The Court of Appeals found that the interline accounts, other than freight and passenger accounts, did not constitute funds held in trust because the revenue collected "merely represent the performance of services by on railroad." 486 F.2d at 528.

and their work is supervised by the Debtor's general manager at Indianapolis. All of the "facts and circumstances surrounding . . . the relationship between the parties supports the conclusion that the Peoria is nothing more than a part of the Debtor's physical plant, for which they are paid "rent" in accordance with the provisions of the operating agreement.[4]

Finally, petitioner argues that even if the operating agreement does not constitute an express or implied trust, the Court should impress a constructive trust on the Debtor's assets. There is no evidence in the record that the Debtor violated a fiduciary obligation, or obtained any of the Peoria's property by fraud, duress, undue influence or mistake. Petitioner's argument in support of the constructive trust is based on two contentions: (1) that the Debtor is an agent for the Peoria and that in that capacity withheld revenues due its principal; and (2) that the Trustees have not been diligent in adopting the operating agreement. Initially, the Debtor was not acting as an agent for the Peoria, as is evidenced by the indemnification provision in the operating agreement which provides that the Debtor is the indemnitor for the Peoria. Agents do not ordinarily indemnify principals against liability for the agents' legitimate acts. In addition, the fact that the operating agreement has not been affirmed or disaffirmed to date cannot form the basis for imposing a constructive trust. As this Court has noted, the Trustees have made every possible effort to comply with the provisions of §77 of the Bankruptcy Act, 11 U.S.C. §205. *In re Penn Central Trans. Co., Memorandum re Proceedings Pursuant to §207(b) of the Rail Reorganization Act of 1973*, 382 F. Supp. 821, 828-830 (E.D. Pa. 1974).

4. The conclusion that the Peoria is not an interline carrier is supported by the fact that the Peoria has no public rates and is not included in the carriers that participate in through routes and joint rates.

The Peoria has not been discriminated against in the administration of the Debtor's estate. The Debtor has not been paying leased line rentals, and in this respect the Peoria is in substantially the same position as other leased lines in the Penn Central system. The petitioner has presented no set of facts which warrant giving the Peoria special consideration over other leased lines similarly situated. Accordingly, for all of the reasons expressed above, the petition to impress a trust on the Debtor's assets is denied.

ORDER NO. 1855

AND NOW, this 23rd day of April, 1975, upon consideration of the Peoria & Eastern Railway Company's petition to impress the Trust upon the assets of the Debtor (Document No. 7521), and the Trustees' opposition thereto, it is ORDERED that the petition is hereby DENIED.

/s/

J.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 75-1701

In the Matter of:

PENN CENTRAL TRANSPORTATION COMPANY,
Debtor

PEORIA AND EASTERN RAILWAY COMPANY,
Appellant

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
D. C. No. B-70-347 In Bankruptcy
(Appealed from D. C. Order No. 1855)

Argued January 5, 1976

Before: VAN DUSEN, ADAMS, and WEIS, *Circuit Judges.*

JUDGMENT ORDER

After consideration of all contentions raised by appellant, it is

ADJUDGED AND ORDERED that Order No. 1855 of the district court be and is hereby affirmed. Costs taxed against appellant.

By the Court,

/s/
Circuit Judge

Attest:

/s/
THOMAS F. QUINN
Clerk

Dated: January 12, 1976

BLEED THROUGH

IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 75-1701

In the Matter of:
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor
PEORIA AND EASTERN RAILWAY COMPANY,
Appellant

SUR PETITION FOR REHEARING

IN BANC

Present: Seitz, *Chief Judge*, Van Dusen, Aldisert, Adams, Gibbons, Rosenn, Weis and Garth, *Circuit Judges*.

The petition for rehearing filed by Appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

/s/
Circuit Judge

Dated: February 10, 1976

[redacted]

[redacted]

[redacted]

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IN THE

Supreme Court of the United States

—

OCTOBER TERM, 1975

—

No. 75-1460

—

PEORIA and EASTERN RAILWAY COMPANY,
Petitioner

v.

TRUSTEES OF THE PENN CENTRAL
TRANSPORTATION COMPANY
Respondents

—

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

—

BRIEF OF RESPONDENTS, TRUSTEES OF PENN CENTRAL TRANSPORTATION COMPANY, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

—

I
OPINIONS BELOW

—

The judgment order of the United States Court of Appeals for the Third Circuit, affirming the decision of the United States District Court for the Eastern District of Pennsylvania overseeing the reorganization of Penn Central Transportation Company (Reorganization Court), is reported in *In re Penn Central Transportation Co.*, 527 F.2d 645 (3d Cir. 1976) and appears in the Appendix to the Peoria and Eastern's Petition (Pet. at A8). The opinion

of the Reorganization Court is reported at 392 F. Supp. 960 (E.D. Pa. 1975), and appears in the Appendix to Peoria and Eastern's Petition (Pet. at A1-A7).

II

QUESTIONS PRESENTED

1. Did the opinion of the Reorganization Court, which was affirmed by the Court of Appeals below, correctly characterize the status of the Peoria and Eastern under its Operating Agreement with the Penn Central?

2. Was the Court of Appeals correct in affirming the decision of the Reorganization Court which held that there was no basis for the creation of a trust to cover the payments owed by Penn Central to the Peoria & Eastern for the use and operation of the line of its railroad?

III

STATEMENT OF THE CASE

This case concerns the status of Petitioner, Peoria & Eastern Railway Co. (P&E), under an Operating Agreement with Penn Central and the effect of the Penn Central's reorganization on the rights of the P&E under the Agreement.

Shortly after its formation in 1890, the P&E turned over its entire line of railroad from Indianapolis, Indiana to Pekin, Illinois to The Cleveland, Cincinnati, Chicago & St. Louis Railway (Big Four) under an Operating Agreement (Agreement) dated February 22, 1890. The Agreement was assigned to the New York Central Railway Co. (New York Central) in 1930 under a 99-year lease by which the New York Central undertook the use and operation of the properties of the Big Four. Penn Central operated the P&E from February 1, 1968, as successor by

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merger of the New York Central, until April 1, 1976 when all of the rail properties of the P&E were conveyed to the Consolidated Rail Corporation (ConRail) pursuant to § 303(b) of the Regional Rail Reorganization Act of 1973, 45 U.S.C. § 744(b).

Under the Operating Agreement, the Big Four, and subsequently, the New York Central and Penn Central, undertook the operation and maintenance of all of the properties of the P&E, including its line of track, rolling stock and equipment. The Agreement required the Big Four to assume all the expenses of the line, including any amounts attributable to depreciation, and to pay annually to the P&E an amount equal to the net revenues derived from its operation within sixty days of the end of the calendar year. Interest at the rate of 6% annually was to accrue if payment was not made within the sixty-day period. If the expenses incurred in operating the line exceeded the revenues derived therefrom, the Big Four was to be reimbursed from subsequent annual earnings, together with interest at 6%.

The Operating Agreement was substantially similar, in purpose and effect, to the long-term leases which formed the basis of nearly 50% of the Penn Central system.[1] Under the Agreement, the properties of the P&E were operated as an integral part of the Penn Central system, and as though it had been wholly owned by Penn Central. From the date of the original Agreement in 1890 until the conveyance of its properties to ConRail in 1976, the P&E performed no rail services whatsoever, collected no revenues from rail operations and paid none of the costs of operating and maintaining its rail properties. Although

1. An excellent explanation of the development of the Penn Central and its predecessors through the devise of the long-term lease is provided in In re Penn Central Transportation Co., 382 F. Supp. 821 (E.D. Pa. 1974).

it maintains a separate corporate existence, all of its corporate and legal obligations have been assumed by Penn Central, which remains primarily liable for their payment. The employees who provide service over P&E's lines are covered by Penn Central's labor agreements and paid from Penn Central's payrolls. Since 1890, the P&E has functioned merely to collect an annual, but contingent, payment from Penn Central or its predecessors which it distributes to its stockholders.

The Penn Central Trustees have been of the opinion that the P&E's status under the Agreement and as part of the Penn Central system is substantially identical to that of Penn Central's leased lines. With the authorization of the Reorganization Court, the Trustees have made no payments to the leased lines pending a determination of whether to affirm or disaffirm the leases under § 77 of the Bankruptcy Act, 11 U.S.C. § 205.[2] *See In re Penn Central Transportation Co.*, 382 F. Supp. 821, 828-30 (E.D. Pa. 1974). Similarly, no payments have been made by the Trustees to the P&E under the Agreement since the Penn Central entered reorganization in June, 1970.

Although Penn Central currently owes $5.8 million under the Agreement, P&E is not in Reorganization and its financial posture appears to be secure for the foreseeable future. Approximately 80% of the outstanding stock of the P&E is either directly or beneficially owned by Penn Central, through its direct ownership of 30% of the P&E and through its control of the Big Four which owns 50% of the company.

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2. At the time of the conveyance to ConRail, approximately 50% of the Penn Central system was operated under 44 leases with 41 American and Canadian subsidiaries of Penn Central. Under § 77 of the Bankruptcy Act, 11 U.S.C. § 205, the Trustees are not bound by terms of the leases unless they affirmatively adopt them. *See* In re Penn Central Transportation Co., 354 F. Supp. 717, 732 (E.D. Pa. 1972).

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In 1974, P&E filed a petition with the Reorganization Court to impress a trust upon the assets of the Penn Central in the amount of the payments owed under the Agreement. In its Memorandum and Order No. 1855 denying the petition, *In re Penn Central Transportation Co.*, 392 F. Supp. 960 (E.D. Pa. 1974) (Pet. at A1-A7) the Reorganization Court held that a debtor-creditor, not a trust, relationship existed between Penn Central and the P&E and that there was no justification for payment under the Operating Agreements where the leased lines had not been paid since the commencement of Penn Central's reorganization proceedings. 392 F. Supp. at 964. The Court of Appeals for the Third Circuit affirmed the decision of the Reorganization Court without an opinion. *In re Penn Central Transportation Co.*, 527 F.2d 645 (3d Cir. 1976).

IV

REASONS FOR NOT GRANTING THE WRIT

A. The Decision of the Court of Appeals Affirming the Reorganization Court's Denial of the P&E's Petition Was Not in Conflict With the Decisions of Any Other Court or With Its Own Earlier Decisions

In its petition before the Reorganization Court and in its appeal to the Third Circuit, P&E asserted that the decision of the Court of Appeals in *In re Penn Central Transportation Co., Appeal of Indiana Harbor Belt R.R.*, 486 F.2d 519 (3d Cir. 1973), which held that interline balances collected by Penn Central on behalf of the other interline carriers were held in trust and were to be paid currently, compelled a similar conclusion in this case. The Reorganization Court in denying the petition, correctly noted a fundamental distinction between the status of the P&E in the Penn Central system and the relationship between the Penn Central and the other interline carriers:

> Unlike the interline situation, the Debtor does not collect money for the Peoria account for services performed by the Peoria. The Peoria performs no services similar to those provided by railroad's participating in interline movements. . . . All of the "facts and circumstances surrounding . . . the relationship" between the parties supports the conclusion that the Peoria is nothing more than a part of the Debtor's physical plant, for which they are paid "rent" in accordance with the provisions of the operating agreement. 392 F. Supp. at 963 (Pet. at A5-A6).

The facts surrounding this case amply support the decision and orders below. The P&E has not, since its

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formation in 1890, performed any rail services, earned any revenues from rail services or performed any maintenance of its track or equipment. In effect, it has merely "leased" its line of railroad for a period of 86 years to the Penn Central, and its predecessors, for which it was paid an annual charge in the amount of the net revenues attributable to the operation of the line. Thus, the earlier decision of the Court of Appeals relating to the payment of interline balances where two or more active railroads participate in a joint movement of freight was entirely inapposite to the facts which faced the Reorganization Court below and nothing in its opinion was inconsistent with the interline decision.

Similarly, it is misleading to describe the relationship between the P&E and the Penn Central as involving a division of earnings. The P&E and the Penn Central were not engaged in a joint enterprise involving the operation of the line in which they divided the revenues derived therefrom. Rather, in consideration of the takeover of the operation and control of its rail properties, the Big Four and subsequently the Penn Central paid to the P&E, a non-operating entity, an amount equal to all of the net revenues earned from traffic moving over the line. In *Terre Haute & I. R.R. v. Cox*, 102 F. 825 (7th Cir. 1900), which the P&E relies upon in its petition, the Court specifically described the agreement before it as providing for a joint operation:

> The undertaking was, in a certain sense, a joint one; each (party) contributed a part of the means whereby it should be carried out. 102 F. at 833.

On this basis, the court held that an arrangement for the division of earnings had been made by the parties and held that the monies collected by one of the railroads were held in trust for the other.

Terre Haute was effectively rendered *sui generis* by a subsequent decision of the Seventh Circuit in *Louisville Bridge Co. v. Chicago, I. & L. Ry.*, 253 F. 631 (7th Cir. 1918), which dealt with a factual situation which was substantially similar to that involved here. In *Louisville*, railroads using and maintaining a bridge over the Ohio River were required to make annual payments to the owner of the bridge. The bridge company intervened in the receivership proceedings of one such railroad, asserting that an amount owed to it by the railroad under the operating agreement was held in trust by the debtor. The Court held that the bridge company was merely a general creditor of the railroad and distinguished *Terre Haute* by limiting it to the specific facts as interpreted by the *Terre Haute* court. The *Louisville* Court stated:

> The agreement (in *Terre Haute*) expressly provided for a division of the earnings. It is clearly distinguishable from a case covering an agreement calling for a payment as rent of a sum equal to a certain per cent of the earnings.
>
> In the present case, we conclude that the contract was one calling for the payment of rent and that the amount of the rent was measured in a somewhat unusual manner. The agreement did not, however, have the effect of giving to the bridge company a right to any specific money received by its lessee. 253 F. at 635.

Unlike the *Terre Haute* court's characterization of the relationship of the parties before it, the Agreement between the P&E and Penn Central created merely a debtor-creditor relationship in which Penn Central paid an annual

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rental charge for the use of the P&E's properties. The duration and circumstances of the Agreement, as well as the position of the P&E in the Penn Central system, convincingly demonstrates that the conclusion of the Reorganization Court below was the only reasonable one to be made on the facts before it. It is respectfully submitted that the orders below were entirely proper and present no conflict with existing law which must be resolved by this Court.

B. This Case Does Not Present an Important Question of Federal Law

The P&E asserts that the decisions of the Court of Appeals and the Reorganization Court below are inconsistent with an earlier Interstate Commerce Commission (Commission) decision which held that the P&E was an interline carrier, *Wood v. New York Central R.R.*, 286 I.C.C. 373 (1952), and that a decision of this Court is required to determine the rights and status of the P&E in the Penn Central reorganization proceedings.

As a matter of fact, the Commission reached precisely the opposite conclusion in *Wood*. There, bondholders of the P&E requested the Commission to require the P&E to publish joint and through tariff rates with the New York Central, on the grounds that revenues associated with its line would thus increase. In refusing to require the P&E to publish its own rates under the Interstate Commerce Act, the Commission stated:

> (I)t is apparent that the provisions of the act are directed, not to operating carriers, but to carriers actually engaged in the transportation of passengers or property as defined in the act. The Peoria & Eastern is not engaged in such transportation. The operation of its properties is performed wholly by the New York

> Central, and it is enough that the latter files tariffs . . . as provided in the act.
> 286 I.C.C. at 379-80.

The essential feature of the interline system is that one of the participating carriers engaged in a line-haul movement of rail traffic collects freight charges on behalf of the other participating carriers solely as a matter of convenience. Because each of the interline carriers actually participates in the movement, and is owed freight charges by the shipper for that participation, the Third Circuit held that freight charges collected by one of the carriers as agent for the other are held in trust for the others. *In re Penn Central Transportation Co., supra.*[3] The finding of the Reorganization Court that P&E is not an interline carrier, 392 F. Supp. at 963 n. 4 (Pet. at A6), was wholly consistent with both the Commission's decision in *Wood* and the earlier opinion of the Court of Appeals.

Furthermore, no important or substantial federal question concerning the rights of the P&E in the Penn Central reorganization is presented by this case. The Reorganization Court correctly found that the P&E's status in the Penn Central system was essentially that of a leased-line, to which rentals have not been paid pending a decision by the Trustees to affirm or disaffirm the leases under § 77 of the Bankruptcy Act, 11 U.S.C. § 205. The right of the Trustees to disaffirm the Operating Agreement as an executory contract in the reorganization proceeding is well-established. *See In re Penn Central Transportation Co.*, 354 F. Supp. 717, 732 (E.D. Pa. 1972). Moreover, whether the Operating Agreement is affirmed or disaffirmed

3. Both the Court of Appeals' and the Reorganization Court's decision in the interline case contain excellent descriptions of the interline system of accounting. *See* In re Penn Central Transportation Co., 340 F. Supp. 857, 858-59 (E.D. Pa. 1972); In re Penn Central Transportation Co., 486 F.2d 519, 523 (3d Cir. 1973).

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in the reorganization process, the claim of the P&E against Penn Central under the Agreement or for the use and occupancy of its property from June 21, 1970 to April 1, 1976 will be accorded the priority of an administrative claim. *Group of Institutional Investors v. Chicago, M. St. P. & P.R.R.*, 318 U.S. 727, 732 (E.D. Pa. 1972). *Palmer v. Palmer,* 104 F.2d 161, 163 (2d Cir. 1959), *cert. denied,* 308 U.S. 590 (1939); *In re United Cigar Stores Co.*, 69 F.2d 513, 515 (2d Cir. 1934). There is no need for this Court to consider and affirm these well-established principles of bankruptcy law.

V

CONCLUSION

The judgment order of the Court of Appeals affirming the decision of the Reorganization Court which held simply that the P&E was entitled to no better treatment in the Penn Central reorganization than the other leased lines was entirely proper. No conflict between or among the circuits exists and no important federal question is presented by the P&E's appeal. Accordingly, the Penn Central Trustees respectfully request that the Petition of the P&E for a Writ of Certiorari be denied.

Respectfully submitted,

CARL HELMETAG, JR.,
JOHN J. EHLINGER, JR.,
Attorneys for Respondents,
Trustees of Penn Central
Transportation Company, Debtor.

VI

CERTIFICATE OF SERVICE

I, Carl Helmetag, Jr., hereby certify that I have caused copies of the foregoing "Brief of Respondents, Trustees of Penn Central Transportation Company, Debtor, In Opposition to Petition for Writ of Certiorari" to be mailed, postage prepaid, by first class mail on Alan C. Kauffman, Esquire, Obermayer, Rebmann, Maxwell & Hippel, 1418 Packard Building, Philadelphia, Pa. 19102.

Dated at Philadelphia, Pa., this thirteenth day of May, 1976.

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Carl Helmetag, Jr.